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SUBJECT: ZARDARI, TARIN ASK NSC LIPTON FOR LEEWAY ON ELECTRICITY
TARIFFS

¶1. (SBU) Summary: In a June 30 meeting, President Zardari asked National Security Council Senior Director David Lipton to help convince the International Financial Institutions (IFIs) to allow Pakistan to delay an increase in electricity tariffs until December and for a subsidized oil facility. Although Lipton appreciated Zardari's concern that increasing electricity tariffs in July would put stress on him politically, Lipton did not agree that the GOP had to wait for adequate power supplies before raising prices. Lipton encouraged the President to work closely with the IFIs to find the best way to eliminate subsidies, but recommended that the GOP not wait until December. In a separate meeting, Finance Adviser Tarin also asked Lipton for immediate market access for Pakistan's exports and a five-year oil financing facility, in addition to quick disbursement of Tokyo pledges and Kerry-Lugar money, as well as Coalition Support Fund reimbursements. End Summary

¶3. (SBU) National Security Council Senior Director for International Economics David Lipton, Deputy Assistant Secretary for Asia Robert Dohner, Economic Advisor to Senior Special Representative for Afghanistan and Pakistan Mary Beth Goodman, and the Ambassador met President Zardari and a GOP delegation (consisting of Finance Adviser Shaukat Tarin, Secretary General to the President Salman Faruqi, Foreign Secretary Salman Bashir, Finance Secretary Salman Siddique, Commerce Secretary Suleman Ghani, and Senator Sughra Imam) at the Presidency on June 30. Lipton told Zardari that President Obama is keenly focused on the GOP's economy, and hoped this visit would elevate the economic dialog between the U.S. and GOP. Lipton acknowledged the difficulties Pakistan had suffered, saying a "perfect storm" hit its economy in the form of a balance of payments crisis, the effects of an overheated economy, a global economic downturn, and a major security problem.

¶4. (SBU) Despite this economic downturn, Lipton highlighted two bright spots: the banking sector, which, due to sound business practices and good regulation, had not experienced large-scale collapses; and the positive rate of GDP growth, unlike the large declines in GDP suffered by some of the more developed countries. On this second issue, Lipton appreciated Pakistan's poverty levels, and the harsh effect that even flat growth can have on its population.

¶5. (SBU) Zardari made a plea for understanding. Specifically, the President would like the United States and the international community to support the GOP's proposal to delay electricity tariff increases until December, when additional rental power units will have presumably come on line. (Note: The Asian Development Bank (ADB), in coordination with the IMF and World Bank, wants Pakistan

to raise tariffs by 17.5 percent, and had agreed to a 10 percent increase in July and the remainder in September. End Note.) The President appreciated the need to reform the power sector, but said his government needed more time from the International Financial Institutions (IFIs). Zardari said increasing tariffs in July would force him from office. President Zardari also asked for \$2 billion per year for five years for energy support.

¶16. (SBU) Lipton acknowledged that the politics of this issue are difficult, but fundamentally disagreed with the GOP's premise that they cannot raise electricity tariffs until additional power comes on line. Rather, Lipton told Zardari, the reverse is true: the GOP cannot increase power output until the power companies improve their fiscal situation. If their balance sheets improve, they will likely be able to supply more power. President Zardari agreed this was true in the long term. However, Lipton said this was also true in the short term. Cash flow is a critical issue for the health of Pakistan State Oil Company and of the state-run electricity distribution companies, noted Lipton. (Note: According to the ADB, the circular debt situation is causing distribution and generating companies to defer critically needed operation and maintenance expenditures; independent power producers and other generators to lack the means to buy sufficient fuel to run at optimal capacity; and the power sector to borrow massively from the banks. End Note.) Lipton said he was uncomfortable supporting a delay until December before raising prices, and made clear that the circular debt needed to be cleared and electricity prices must reflect the full cost.

¶17. (SBU) Zardari argued that, since the current conflict was causing higher unemployment and an IDP crisis, he could not force the people to pay higher electricity prices. Moreover, unemployment

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only added to the ranks of the extremists who used drug money to entice the economically disadvantaged. Zardari asked for assistance in cutting down the costs of fuel imports in order to make it easier for the GOP to restructure its existing power sector industries. He then asked Lipton to explain (presumably to the IFIs and the USG) the difficult position reforming the energy sector placed him in with the people of Pakistan.

¶18. (SBU) Lipton promised to bring the tariff issue up with the World Bank and IMF. He noted the U.S. was sensitive to the political problems associated with tariff increases, and that IMF austerity measures had caused political instability in other countries, something which must be avoided in Pakistan. However, Lipton made clear to Zardari that he believed the right approach was to work cooperatively with the IFIs, while accepting that tough decisions must be made. Lipton said that convincing the IFIs to accept a plan that continued energy subsidies until December would be a tough sell, and that he did not encourage the GOP to make such a presentation.

¶19. (SBU) Lipton emphasized the importance of Pakistan's improving its tax-to-GDP ratio, as a ratio below 10 percent was dangerous to any economy. Lipton applauded Finance Advisor Tarin's determination to broaden the current tax base. Lipton cited the examples of Turkey and Egypt, which twenty years ago had lower tax-to-GDP ratios than Pakistan did and were experiencing much lower growth. Today the reverse is true.

¶110. (SBU) In a separate meeting with Finance Ministry officials (Tarin, Minister of State for Economics Hina Rabbani Khar, Finance Secretary Salman Siddique, Additional Secretaries Asif Bajwa and Abdul Rauf) earlier in the afternoon, many of the same points were made. Tarin gave an overview of Pakistan's economic situation over the past year as it faced a legacy of flawed, consumption driven macro-economic policies, deteriorating terms of trade, the global financial crisis, and the adverse impact of the war on terror. Tarin reviewed the government's nine-point plan to deal with the crisis (stabilization, social protection, improving the agricultural sector and industrial competitiveness, human resource development, energy, capital markets, public-private partnerships for infrastructure development, and administrative reform).

¶111. (SBU) Tarin asked the U.S. for enhanced market access

immediately (as the ROZ's would take several years to come into effect), a subsidized five-year oil facility, and timely receipt of Tokyo pledges, Kerry-Lugar pledges and Coalition Support Fund refund payments. He also asked that assistance flows be directed towards credible, established Pakistani institutions, and to defer electrical tariff increases until load-shedding is eliminated, as well as financial support for eliminating circular debt. Tarin said he would be in Washington July 16-17 to meet with the World Bank.

¶12. (SBU) Lipton promised U.S. support in general, and to provide more clarity on the Tokyo pledges and CSF refunds, but stated what he later reiterated to the President: load-shedding could not be eliminated until tariffs were increased. He mentioned the burden that circular debt had placed on the banks' balance sheets, potentially crowding out more productive lending, and offered to provide technical assistance to the GOP to help devise ways to correct the situation.

¶13. (SBU) Comment: It is not clear whether the GOP actually will renege on its agreement with the IFIs to eliminate electricity subsidies fully by September, or whether it is approaching major donors for support in a last-ditch attempt to put off the inevitable. Its promise last November to eliminate subsidies by the end of June 2009 was greeted with skepticism by many. We are also somewhat skeptical of Zardari's claim that his government will fall if rates are increased. Until a few days ago, our consulates had expressed surprise at the lack of major protests in Lahore and Karachi over load-shedding, and statistics had indicated that the GOP had actually brought down the shortfall from 5,000 MW to 2,400 MW. Unfortunately, a major line failure this week has caused the gap to widen considerably, which may be putting added pressure on the government. We believe the GOP needs to undertake a comprehensive public education campaign to explain their position transparently, and ask for the people's understanding and sacrifice while support for the conflict is still strong. There will never be

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an ideal time to eliminate subsidies, and this may be as good as it gets for the Zardari government.

¶14. (U) NSC Lipton has cleared this cable.

PATTERSON